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Granules India Limited

Sailing Strong

Pharmaceuticals	Sharekhan code: GRANULES	Result Update

Summary

- We maintain a Buy on the stock of Granules with an unchanged PT of Rs. 475.
- Q3FY2021 was a mixed quarter with revenues at Rs. 845 crore, up by 20% y-o-y, while the PAT at Rs 146 crore, versus Rs. 96 crore in Q3FY2020.
- Tapping new geographies, strong product pipeline, growth in existing core molecules & capacity expansion would drive sales growth. Favourable mix, benefits of operating leverage accruing would lift OPM.
- Better growth prospects, strong earnings visibility, a sturdy balance sheet and healthy return ratios augur well for growth

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 354**	
Price Target: **Rs. 475**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

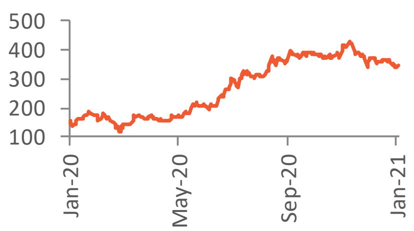
Company details

Market cap:	Rs. 8,757 cr
52-week high/low:	Rs. 438 / 115
NSE volume: (No of shares)	40 lakh
BSE code:	532482
NSE code:	GRANULES
Free float: (No of shares)	14.3 cr

Shareholding (%)

Promoters	42.0
FII	28.0
DII	0.2
Others	29.82

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.0	-6.4	21.2	132.7
Relative to Sensex	-4.0	-23.8	-0.6	118.2

Sharekhan Research, Bloomberg

Granules India Limited (Granules) reported a mixed set of results for Q3FY2021 with the operating performance missing expectations, while higher other income resulted in PAT slightly ahead of estimates. Revenues at Rs 845 cr grew 20% y-o-y backed by strong double digit growth across all the segments of API (Active Pharmaceutical ingredients) – up 20%, PFI (Pharmaceutical formulations intermediates) – up 48% YoY and FD's (Finished Dosages) up 11.2% y-o-y. The operating margins 25.1% expanded 190 bps y-o-y on the back of 300 bps YoY expansion in gross margin largely attributable to favorable mix and better efficiencies due to higher utilization levels. However sequentially, the operating margins contracted by 480 bps on the back of a 420 bps contraction in gross margins, on account of covid led challenges which resulted in supply chain and logistics issues. Operating profits stood at Rs 211.6 cr, up 29.7% y-o-y for the quarter. The adjusted PAT for the quarter stood at Rs 146 crore, as against Rs 96 cr in Q3FY2020 and was slightly ahead of estimates. Granules sees strong demand traction across its segments and expects the same to sustain going ahead as well. Tapping new geographies for growth, a strong product pipeline and benefits of incremental capacities (including the MUPS block) would be key revenue drivers. Also Granules has announced an incremental capex of Rs 400 cr towards setting up a new facility for PFI – FD at Genome valley Hyderabad, which is expected to be ready in early FY2024 and provides visibly for growth going ahead. A favorable mix, operating efficiencies generated due to benefits of operating leverage and higher margins from new product launches would results in OPM expansion. Consequently, Granules sees its margin trajectory to be in the range of 25-27% as compared to 21.1% as of FY2020. Further, during Q3FY2021, Granules had confronted challenges on the supply chain and logistics front which, it excepts to sustain in Q4Y2021. Granules is weighing alternative options so as to be able to tide over the challenges. Citing caution, the management expects PAT growth for FY2021 to be around 60-70% as compared to 70-80% guided earlier. A sturdy topline growth, expansion in operating margins leading to a strong earnings growth, healthy return ratios and a strong balance sheet position augur well and are the key positives for Granules.

Key positives

- The PFI segment revenues grew by a sturdy 48% y-o-y due to increasing penetration of PFI segment
- API segment revenues were up 20% due to an addition of new customer.
- Announced incremental Capex of Rs 400 crore for setting a new PFI-FD plant at Hyderabad

Key negatives

- FD segment growth slows down to 11.2% after consecutive quarters of a 20% + growth.
- PAT growth guidance revised to 60-70% from earlier 70 -80% citing near term pandemic led headwinds.

Our Call

Maintain Buy with an unchanged PT of Rs 475: Granules is witnessing strong demand tractions across segments, which is expected to sustain further . Going ahead, growth for the company would be fueled by new product launches, increasing geographical penetration, capacity expansion, commissioning of MUPS block by Q4FY22 and fortifying growth in the core molecules. Further, a favorable revenue mix and operational efficiencies would drive the margins. Envisaging a strong demand, the company has announced an incremental capex of Rs 400 crore for setting up a new PFI-FD facility, which would be ready by early FY2024 and provides ample visibility on the growth. Granules has reported mixed performance for Q3FY2021. On the basis of the above positives, we have revised our earnings estimates upwards for FY2023 by 4% whilst have largely retained FY2022 estimates. At CMP, the stock is trading at P/E multiple of 13.5x/11.1x its FY22/FY23E EPS. Better growth prospects, strong earnings visibility, a sturdy balance sheet and healthy return ratios augur well from a growth perspective. We maintain our Buy recommendation on the stock with an unchanged PT of Rs 475.

Key Risks

A delay in product approvals or the negative outcome of facility inspection by the USFDA can affect future earnings prospects.

Valuation (Consolidated) Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
Net Sales	2279.2	2598.6	3244.1	3821.0	4540.0
EBIDTA	384.0	547.3	850.0	1022.1	1225.8
OPM (%)	16.8	21.1	26.2	26.7	27.0
Reported PAT	236.4	329.7	539.9	646.7	787.0
EPS (Rs)	9.6	13.3	21.8	26.2	31.8
PER (x)	37.0	26.5	16.2	13.5	11.1
EV/Ebidta (x)	24.7	17.1	10.3	8.4	6.8
P/BV (x)	5.7	4.7	3.8	3.0	2.5
ROCE (%)	11.6	15.8	23.7	24.7	26.7
RONW (%)	15.5	17.9	23.3	22.4	22.5

Source: Company; Sharekhan estimates

Mixed quarter: Granules reported a mixed set of results for the quarter with the operating performance missing expectations, while higher other income resulted in PAT slightly ahead of our estimates. Sales for the quarter grew sturdily by 20% y—o-y to Rs 845 crore lead by a strong double digit growth across all segment – PFI segment grew the most by 48% y-o-y, FD segment sales grew 11% y-o-y, & API segment sales were up 20%. During the quarter, Granules launched four new products and simultaneously reported market share increase in existing products. Operating profit reported a growth of 29.7% y-o-y to Rs 211.6 crore, but were down sequentially by 17.5%. OPM expanded by 190 BPS y-o-y to 25.1% during the quarter, led by 300 bps y-o-y improvements in the gross margins largely attributable to favorable mix and better efficiencies due to higher utilization levels. However, on a sequential basis, the operating margins shrunk by 480 bps on the back of a 420-bps contraction in gross margins due to higher raw material prices. The other income for the quarter was higher at Rs 16.4 cr as compared to Rs 3.5 cr in Q3FY20 attributable to stimulus received by the US subsidiary on account of CARES Act in form of forgivable loan after meeting the criteria of forgiveness. The tax rate for the quarter stood at 20.2% as compared to 28% in corresponding quarter previous year. Consequently, the adjusted PAT stood at Rs 146 cr as against Rs 96 cr in Q3FY20 and was is slightly ahead of the estimated Rs 138 cr.

Core molecules continue to stage healthy growth; Strong new product pipeline provides visibility on growth; Management retains PAT growth guidance of 25% to 30% beyond FY2021: Granules reported a healthy performance for Q3FY21 with all the three segments reporting a double digit growth on the back of a healthy demand environment for its drugs. Granules expects the sturdy performance to sustain going ahead as well. The core molecules (around 84% of Q3FY2021 sales) would continue to sustain the robust growth trajectory as Granules looks to expand / penetrate new geographies of Europe, Canada and South Africa and Australia, which would enable growth of its core molecules basket. Further Granules has a strong pipeline of products. It has a total of 35 approved ANDA's including 1 tentative approval. The US subsidiary of the company has received around 17 approvals in FY2021 and has launched around 7 products in 9M FY2021. It plans to launch another 2-3 products in remainder of FY2021, while the balance would be pushed to FY2022. Of the new product approvals, 2 are MUPS (Multi Unit Pallet System) technology based products, which command a relatively higher margins. This points at a strong product pipeline. Consequently, given the strong demand, healthy product pipeline and new capacities being set up, the revenues and PAT are expected to grow impressively over the next two years. However in the near term, Granules expects some bit challenges in the supply chain and logistics part due to the after effects of the pandemic after effects, which could continue to be reflected in Q4FY2021 performance. The management is charting out alternate options, which would largely offset the effect of the challenges and has resorted to a cautious stance. Granules thereby revises the PAT growth guidance to 60-70% for FY2021 whilst maintaining the 25-30% PAT growth guidance beyond FY2021.

Granules to invest Rs 400 crore towards a new PFI-FD facility in Genome Valley; plant to be operational in early FY2024: Granules has announced setting up of a new plant for PFI – FD at Genome Valley Hyderabad with an outlay of Rs 400 crore. The company has acquired the land for the said plant and the construction work is about to commence. The new facility would house a capacity of 10 bn units of Oral Solid dosages (OSD) and other dosage forms as well as also increase the capacity for PFI's. The new plant announcement comes on the back of an expected tractions in business across the PFI and FD segments. The existing capacities would support the demand over the next two years, post which, Granules expects the contribution form the new facility to support the growth. In addition to this, Granules is progressing as per schedule with the on going capacity expansion plan of Rs 400 cr encompassing the setting up of a MUPS unit and capacity expansion plans. Announcement of the new capex plan points towards a strong growth visibility going ahead.

Q3FY2021 Concall highlights:

Core business: Granules core molecules accounted for 84% of total revenues for the quarter and the contribution has remained stable, thereby pointing at a sustained strong growth. With the US markets largely maturing for Granule's core molecules, the company is now in the process to tap / penetrate new geographies like Europe, South Africa, Canada so as to support the growth. The share of Europe in total sales stands at 23% which is expected to reach 28% by FY2023. While the share of revenues from the US is expected to decline to 43% by FY2023 from 50% currently.

Segmental revenue mix: As of Q3FY2021, the API segment recorded a healthy growth of 20.5% y-o-y to Rs 252 crore, largely due to new customer additions. PFI segment revenues continued its strong growth trajectory clocking a growth of 48% y-o-y to Rs 171 cr due to increasing penetration of PFI as a segment. The FD segment revenue growth slowed down for the quarter to 11.2% YoY to Rs 422 cr.

Product Pipeline: Granules has a strong product pipeline which would fuel the growth in the times to come. The company looks to add a total of 23 new products in between FY2021 to FY2023 across all dosage forms in FD's. Granules aims to file 7-8 new ANDA's and 2-4 dossiers every year. Further, the management has specified that it had delayed a few launches so as to ensure un-interrupted supply of existing products. Granules is also looking to relaunch Metformin 750 mg in the US markets over the next 1-3 quarters. It had recalled the drug from the US markets a couple of quarters back.

Capex plans: Granules is in the midst of a massive Rs 400 crore capacity expansion plan spread over FY2021 and FY2022. This includes de bottlenecking the existing plants and putting up a new block at an existing facility. The de bottlenecking exercises are likely to go on stream in FY2021, thus adding to the top line growth. Secondly, Granules is also putting up a Multi Unit Pallet System (MUPS) at its plant. The MUPS is an advanced technology which can also boost operating efficiencies. The MUPS block will have a capacity to manufacture 2.5 – 5 Bn Finished Dosages per annum and will be operational by Q4FY22. The said block would be set up at an already approved facility and hence can commence commercial production immediately once it is ready. In addition to the above, the company has announced an additional capex plan of Rs 400 towards setting up a new plan at Genome valley – Hyderabad for PFI and FD's including OSD's and other dosage forms.

Q4FY2021 to reflect challenges due to pandemic after effects: Granules is witnessing challenges in the supply chain and logistics especially with the import of the raw material. Lack of container availability and delayed transit time has overweighed on the routine operations. This has also resulted in an increase in the raw material prices, which the management is confident of passing on to its customers, though with a lag of over 3-4 months. Granules is weighing alternate options so as to tide over the challenges and expects a minimal impact of these on the routine operations. However, post Q4FY2021, the management expects the business to regain normalcy and continue to grow.

Net Debt: Granules had managed to reduce its net debt position by 22% y-o-y as of Q3FY2021. The gross debt stood at Rs 837 cr as compared to Rs 857 cr in the previous quarter.

R&D expenses: Granules has incurred Rs 22 cr on the R&D for Q3FY2021 while for 9MFY2021 the R&D spends stood at Rs 64 crs.

Results **Rs cr**

Particulars (Rs Cr)	Q3FY2021	Q3FY2020	YoY %	Q2FY2021	QoQ %
Total Income	844.5	704.0	20.0	858.1	-1.6
Expenditure	633.0	540.8	17.0	601.7	5.2
Operating profit	211.6	163.1	29.7	256.4	-17.5
Other income	16.4	3.5	367.6	3.2	409.3
EBIDTA	228.0	166.7	36.8	259.6	-12.2
Interest	7.2	6.7	7.7	6.3	15.6
Depreciation	36.8	39.0	-5.5	36.1	2.2
PBT	183.9	120.9	52.1	217.3	-15.4
Tax	37.1	24.9	49.1	53.7	-30.9
Adjusted PAT	146.8	96.1	52.8	163.6	-10.3
Reported PAT	146.8	64.0	129.3	163.6	-10.3
			BPS		**BPS**
OPM (%)	25.1	23.2	187.5	29.9	-482.9

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Growth momentum to improve:

Indian pharmaceutical companies are better placed to harness opportunities and clock healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in US generics market), rise in product approvals and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be the key growth drivers. This would be complemented by the strong capabilities developed by Indian companies (leading to a shift towards complex molecules, biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies

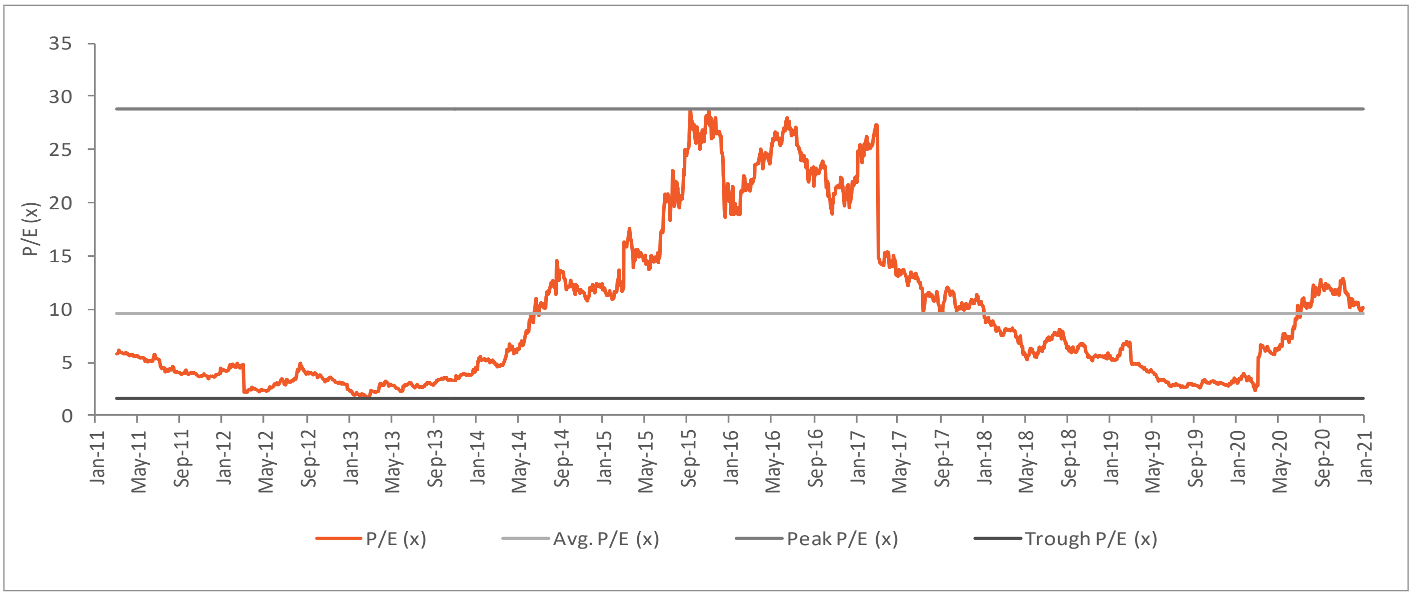
■ Company outlook - Healthy prospects:

Granules is a fully integrated pharmaceutical company with presence across the API-PFI-FD value chain. The company is witnessing an improved demand environment across its products. The core molecules are likely to sustain the strong growth trajectory, as the company plans to tap new geographies of Europe, Canada and South Africa for growth. A strong product pipeline would add to the revenue growth. Granules has announced a capex wherein it plans to increase its capacities to cater to the increased demand. A part of the capex plan encompassing de-bottlenecking and setting up MUPS block is expected to be ready by Q4FY2022 and operations are expected to commence thereafter. While the balance part of capex which includes setting up a new facility at Genome valley for PFI and FDs is likely to be ready in early FY2024. We believe that new product launches in the US, tapping new geographies and augmented capacities will support the base business as well as emerging business. A changing mix (increasing share of high margin PFI and FD Segment) and efficient manufacturing process coupled with better utilization of plants will aid profitability growth.

■ Valuation - Maintain Buy with an unchanged PT of Rs 475:

Granules is witnessing strong demand tractions across segments, which is expected to sustain. Going ahead, growth for the company would be fueled by new product launches, increasing geographical penetration, capacity expansion, commissioning of MUPS block by Q4FY22 and fortifying growth in the core molecules. Further, a favorable revenue mix, operational efficiencies would drive the margins. Envisaging a strong demand, the company has announced an incremental capex of Rs 400 crore for setting up a new PFI-FD facility, which would be ready by early FY2024 and provides ample visibility on the growth. Granules has reported mixed performance for Q3FY2021. Basis the above positives we have revised our earnings estimates upwards for FY2023 by 4% whilst have largely retained FY2022 estimates. At CMP, the stock is trading at P/E multiple of 13.5x/11.1x its FY22/FY23E EPS. Better growth prospects, strong earnings visibility, a sturdy balance sheet and healthy return ratios augur well from a growth perspective. We maintain our Buy recommendation on the stock with an unchanged PT of Rs 475.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP (Rs / Share)	O/S Shares (Crs)	Mcap (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Granules India	354.0	24.7	8,757.0	26.5	16.2	13.5	17.1	10.3	8.4	17.9	23.3	22.4
Laurus Labs	358.0	53.2	19,197.0	74.6	23.3	20.8	35.5	15.3	13.5	14.4	31.6	26.1

Source: Company, Sharekhan estimates

About company

Granules is a vertically integrated pharmaceutical company, headquartered in Hyderabad, India. The company manufactures Active Pharmaceutical Ingredients (APIs) – 29.7% of sales, Pharmaceutical Formulation Intermediates (PFIs) – 20.2% of sales and Finished Dosages (FDs) – 50.1% of sales and supplies them to both regulated and semi-regulated markets. The regulated markets constitute around 73% of revenues, while LATAM accounts for 11% of revenues and RoW markets constitute around 16% of revenues.

Investment theme

Granules is a fully integrated pharmaceutical company with presence across the API-PFI-FD value chain. The company is witnessing an improved demand environment across its products. The core molecules are likely to sustain the strong growth trajectory, as the company plans to tap new geographies of Europe, Canada and South Africa for growth. A strong product pipeline would add to the revenue growth. Granules has announced a capex wherein it plans to increase its capacities to cater to the increased demand. We believe that new product launches in the US, tapping new geographies and augmented capacities will support the base business as well as emerging business. A changing mix (increasing share of high margin PFI and FD Segment) and efficient manufacturing process coupled with better utilization of plants will aid profitability growth.

Key Risks

- Delay in product approvals or negative outcome of facility inspection by the USFDA can affect future earnings prospects.
- Delay in product launches in the U.S.
- Adverse outcome of USFDA inspection at manufacturing facility also poses risk.

Additional Data

Key management personnel

Mr. Krishna Prasad Chigurupati	Chairman and Managing Director
Mrs. Uma Chigurupati	Executive Director
Ms. Priyanka Chigurupati	Executive Director of Granules Pharmaceuticals Inc
Mr. Sandip Neogi	CFO

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	3.07
2	Norges Bank	3.04
3	GOVERNMENT PENSION FUND - GLOBAL	2.99
4	Vangaurd Group Inc	1.91
5	Mahima Stocks Pvt Ltd	1.66
6	TYCHE INVESTMENTS PVT LTD	1.47
7	Dimensional Fund Advisors LLP	1.41
8	BlackRock Inc	1.09
9	DNB Asia	0.37
10	State Street Corp	0.45

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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by BNP PARIBAS

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